RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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November 2, 1983 **LETTER 873**

THE PICTURE: A lot of people are discouraged by the "surface action" of this market. They're afraid Wall Street is going to fall apart. But sub-surface, the action is most interesting–and hopeful. The D-J Transportation Average is acting well–having hit a record high of 593.29 only last week (Oct. 24). Two days later, on October 26, the D-J Utility Average struck its highest level since 1969. All of this served to confirm a record D-J Industrial high of 1284.65 touched on October 10.

Now refer to the page 1 chart. Note that on October 3 the Dow hit a low of 1231.30, while on the same day the Transports struck a low of 560.79. What could happen next? We could see an Industrial break below 1231.30, unconfirmed by the Transports (Transports could refuse to close under 560.79). Such action would provide a bullish downside non-confirmation.

Now read this carefully–from a major basing standpoint, the advance-decline ratio (see page 2 chart) could easily break below its August low–but unconfirmed by the Dow (the Dow would refuse to break below its own August low of 1163.06). Such action would be very constructive.

Let me put it this way. If someone was to ask me, "Russell, give me a prescription for a major technical base in this area," I would answer as follows: "Here's what I'd like to see. I'd like to see the D-J Industrial Average break below 1234.30 with Transports refusing to confirm (the Transports would have to hold above 560.79). At the same time, I'd like to see the A-D ratio drop below its August low with Industrials not confirming (Industrials would have to hold ABOVE the August low of 1163.06). That kind of action could give us a major base with two sets of non-nonfirmations arriving in one fell swoop! The downside action (with breadth sinking) would also serve to turn almost everyone bearish, and this is just the kind of pessimistic sentiment that is needed at an important market bottom."

Many people (who have not studied the subject) believe that a sagging A-D ratio always leads to a market fiasco. Nothing could be further from the truth. Many times in the past a sagging A-D ratio has led the way to a major market bottom. These bottoms are almost always signalled by a new low in the A-D ratio, a low that is *not confirmed* by the Dow.

Last week I went over my historical chart and found numerous instances where a new low in the A-D ratio, a low unconfirmed by the Dow, paved the way for a major market bottom. Some important and dramatic examples are March-April, 1933, July-September, 1934, March-May, 1937, October-December, 1957, June-September, 1959, July-September, 1961, June-October, 1962, July-October, 1972, December, 1974, and February-November, 1978.

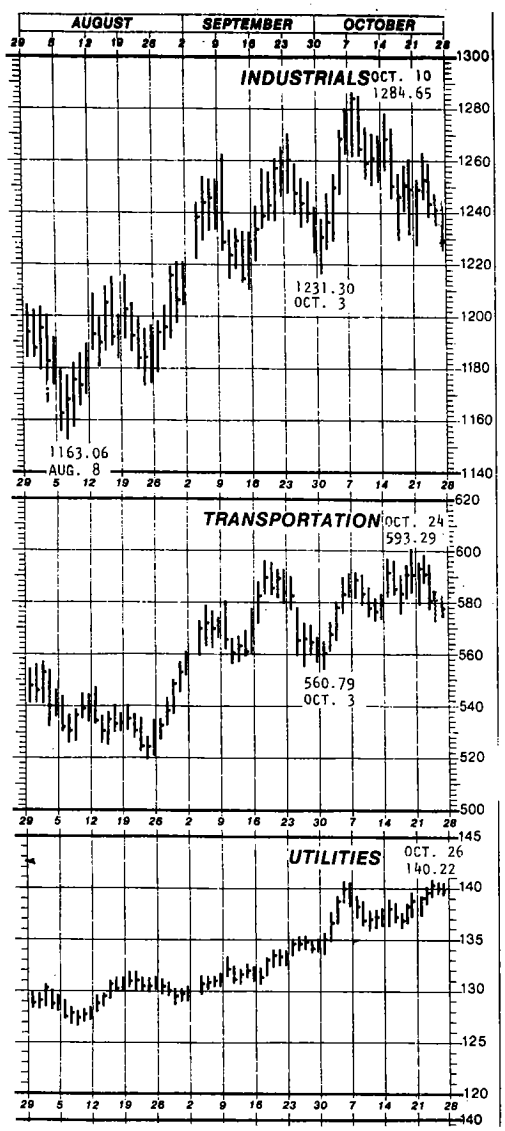
To sum up, I believe the technical situation is shaping up for a good market bottom to appear over the next month or so.

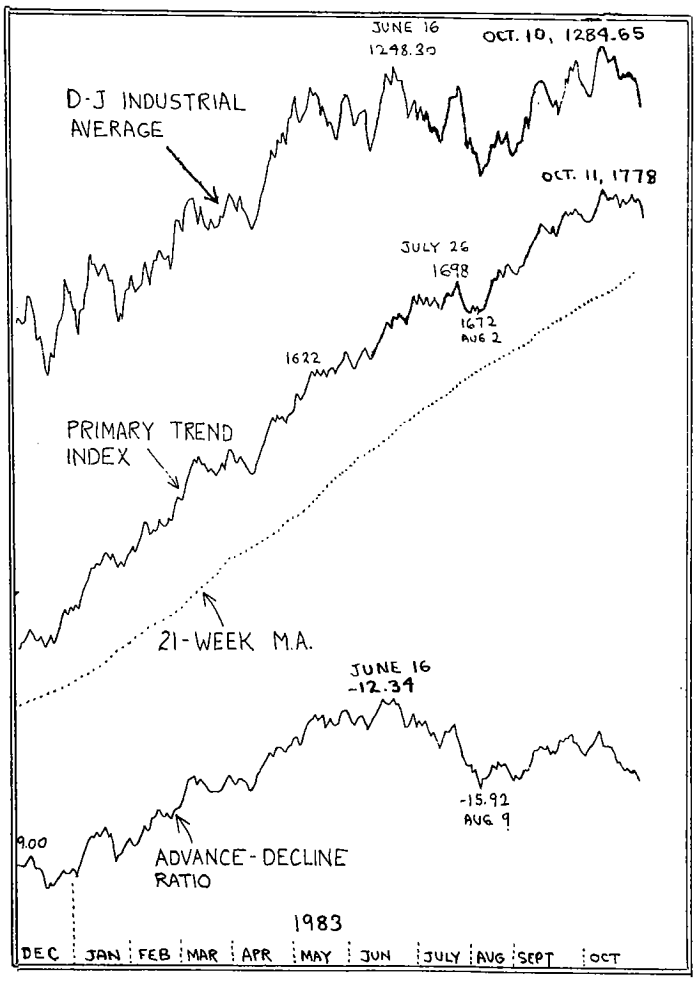
Oct. 21; DJIA 1249.09; PTI 1766; A-D Ratio -15.14
Oct. 28; DJIA 1223.48; PTI 1756; A-D Ratio -15.73

A good bottom would entail a further drop of about a point in the A-D ratio, a drop that in all probability would NOT be confirmed by the D-J Industrial Average.

Question: Russell, I note what you said about the D-J Utility Average in the last Letter, and I realize that the pioneer Dow Theorists did not use the Utilities in their market analyses. But what can you say about the Utility Average now?

Answer: I did say that George Schaefer (the great Dow Theorist who died in 1974) made use of the Utilities. Schaefer believed that the Utility Average is a bellwether for the rest of the market. Last week, on October 26, the D-J Utility Average closed at 140.22. This was the highest level for Utilities in 14 years. If you





study daily charts of the Averages you will see that the Utility Average has a habit of turning down at major tops well *before* the rest of the market. In fact, Ned Davis (Davis Research (1-800/241-0621) observes that in the past three decades there was not a single instance of the market topping out without advance warning from the Utilities. So Davis states, "If the market were to have an 'October Massacre' now (as many have predicted) it would be the first time in 30 years that theDow Utilities had failed to give an advance warning."

My conclusion, therefore, is that the major 18-year high on the D-J Utility Average (struck a few weeks ago on October 6) was a positive indication for the market. In the past the Utility Average has turned down (on average) about four months ahead of the rest of the market. But here we have a case where the Utility Average hit a new high four months beyond the June 16 peak in the A-D ratio.

Question: (This is from a letter received Oct. 14): "I saw Joseph Granville on Financial News Network the other day and what he said scared the hell out of me. I know he has been shouting 'Wolf' for some time, but now he says it's only a matter of weeks before we will have the worst stock market fall since 1929. He states that this one will be much worse and will wipe us all out. He refers to all sorts of historical parallels. Would you comment on this, please?" (T.D.H. Miami).

Answer: I seldom comment on the opinions of fellow advisors, but I have been receiving quite a bit of mail on the Granville view. First, I want to say that I have known Joe since 1961, and I respect his opinions and his abilities. Furthermore, I have never carried on arguments or the so-called "exchanges" with fellow letter-writers. As far as I am concerned, all my energy should be directed at trying to get in harmony with the markets, not in trying to stir up excitement through battles with other analysts.

Joe has a perfect right to his opinion–just as I have to mine. Ultimately, of course, the market will have the final word, and if that word is that I am wrong then I better forget about pride and get in step with what is happening.

The Dow has just risen 508 points in the largest point-advance in stock market history. Many analysts believe that "that's it–that's all there is." I don't think so. I think that this is a continuing bull market, and that in due time we'll see higher prices and a continuation of the primary bull trend. My studies have not broken down, and what is happening now is not unexpected. There has been a lot of speculation, a lot of froth, and a lot of nonsense going on in this market. Normally, before a bull market is ready to take off again Wall Street moves to dampen the speculation. Wall Street does that by making traders and speculators pay for their enthusiasm and foolishness. They pay via lost profits and margin calls.

After the initial up-phase of every bull market there is a period of pain. It happened in 1933, it happened in 1943, it happened in 1953, it happened in 1976, and it's happening now. But I repeat, I don't think this is the end of the bull market. Granville's pronouncements have no more effect on the market than mine do. In the end, Wall Street and the tape will tell the story. At that time, Joe and I will get in harmony with the markets or suffer the consequences. And there is nothing that I would less rather do than fight the verdict of the market.

Question: Russell, if the bull market is to continue, what is there to sustain it?

Answer: There is only one thing that will sustain a primary bull market and that is rising earnings. In a recent interview, Joseph McAlinden, president of the prestigious *Argus Research Corp.* stated that the Dow will have earnings of $80 this year, $150 next year and $175 in 1985. If this is true, then the Dow at 11 or 12 times earnings could easily rise to 2,000.

Question: You wrote at length about the short interest ratio in the last two Letters. Now I note that the latest (October) figures show the total short interest up 8.4% to a record 182.8 million shares and the AMEX short interest up 7.4% to 16.4 million shares. What does this mean?

Answer: I view this as evidence that an increasing number of bears are fighting the primary bull trend. It is simply incredible how unwilling the bears are to admit that the bull is in command of this market. But the huge bear segment constitutes a major bullish plus for the market. It tells us that the bull market has much further to go–and that it will last much longer than people expect. I say this because the massive short interest is evidence that the bullish forces are still far from expressing themselves fully.

One indication of the "final top" for the bull will be exactly the opposite of what we see today. Near the ultimate top we'll have nothing like 182 million NYSE shorts. In fact, it wouldn't surprise me to see that total short interest at the final top drop well below 100 million. Another item to think about is that any

day that volume on the NYSE drops under 91 million shares will be a day when the short interest ratio rises above 2.00 (which is a very bullish reading). And on a day when the volume drops to say 70 million shares the ratio will rise to 2.60 on that day (an incredibly high reading). Frankly, the most bullish thing we could see here would be a period of low volume with the market simply backing and filling. I'd love to see average volume of 50-70 million shares for a month or so!

INVESTMENT POSITION: With the PTI within 14 points of its recent record high, with the major Averages having reconfirmed the primary direction, the bull stays in the box. Policy is to sit with T-bills, T-bonds and the better-acting no-load funds. Examples of the latter are Twentieth Century Ultra (816/531-5575), Hartwell Growth (212/308-3355), Fidelity Magellan (800/225-6190), Lehman Capital (800/221-5350), Twentieth Century Select (816/531-5575). By the way, the current issue of *Money* magazine (Nov.) contains a superb run-down on the funds and is well worth studying.

MORE ON THE BULL MARKET: I spoke to a group of new brokers last week. They asked me how I operate, how I think. I told them, "I start with first things first. In my mind, the first thing you must know is the direction of the primary trend of the market. All other information is secondary. So I start by classifying the trend under Dow Theory, and under Dow Theory we are now in a bull market. Then I look for corroborative evidence. I read various magazines and newspapers for most of the afternoon, and (hopefully) this helps me to put the pieces together. And if the pieces DON'T jibe with the generally held opinions, the consensus opinions, so much the better."

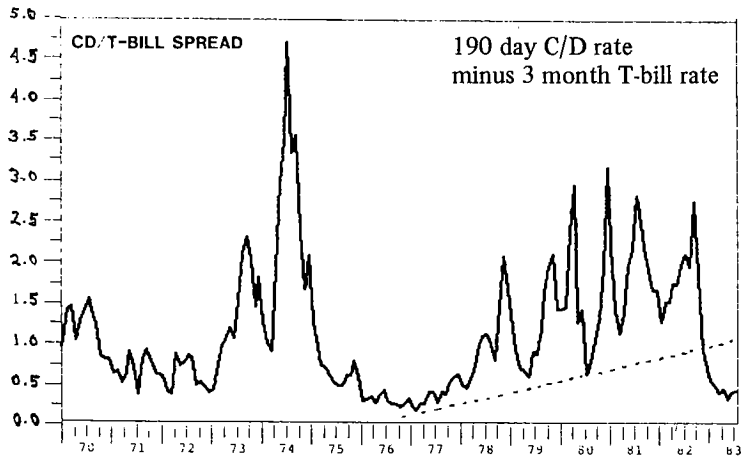
Right now I know there's a lot of skepticism regarding this bull market. Many people believe it's now over, others think it may continue, but that the market is fated to go into the tank first. One study (it appeared in Letter 869) sticks in my mind. It was the long-term momentum study, showing that only three times in this century did the S & P 500 move to a level of 50% or more above its level of one year ago. In May of 1943 the momentum index rose to just over 50%. It took 11 months of backing and filling (until April, 1944) before the corrective process ended.

In July, 1983 the momentum for the S & P 500 went slightly over 50% again. We've been in a strange, backing and filling, spurting and diving market ever since. If history repeats, if it takes roughly 11 months again to work off the over-bought pressures of a 50% momentum figure, then it could be around June of 1984 before this market is ready to take off again.

So what's wrong with that? Suppose it does take until mid-1984 for this market to work all pressures and speculative intensity and foam and froth off? What's our hurry? The bull market will simply extend, and it will go higher and farther than it would have otherwise. After all, the stock market doesn't arrange itself for your conveniences or my convenience. Hardly. No, the "awful truth" is that the stock market arranges itself for our INCONVENIENCE! The market tries to do what will drive the greatest number of people up the wall. The market thrives on frustrating traders and investors. And where could we find a greater frustration, for instance, than a primary bull market that won't fall apart (thereby frustrating the bears) and yet one that won't take off (thereby frustrating the bulls).

If this market follows the 1943-44 example and backs and fills until June of 1984 it will have Wall Street pulling its hair out and the public watching the US Football League instead of the boardroom tape. And that may be just what this bull market wants.

Remember, a bull market tries to go up while taking the fewest number of investors with it. Of course, eventually the public climbs aboard, but around that time the bull is either over or ready for a drastic correction. Conversely, a bear market tries to go down while taking as many investors as possible with it. The bear loves to take the crowd down to defeat, and it does it with hopes, disbelief and sporadic (very impressive) rallies.



Now there are a few charts that I feel are worth examining at this point. One is a long-term "confidence" chart based on the spread between the yields on the very safe US T-bills and the less safe bank certificates of deposit. Note how the spread moved up during 1973 and 1974 as people moved out of C/D's and into T-bills for safety purposes. Now look at the big decline in the yield spread during 1982 and 1983 as investors paid far less premium for the safety of T-bills over C/D's. Conclusion: investment money is not that worried about the safety of banking system—regardless of the fear talk and the newspaper coverage. This is the kind of confidence you need in a bull market—the confidence of big money. (chart courtesy of Weiss Research, Box 2923, W. Palm Beach, FL 33402).

On pg. 5 is a very interesting chart. It shows a very long term chart of the year-to-year change in US Consumer Price Index. Note that a trend of rising inflation, a trend that started in 1921, was shattered over the past year. Now this is no baby trend! No this is a trend that has lasted 61 years—and lately it has been reversed. You may be convinced that inflation is here to stay, you may be convinced that there's only one path for the Consumer Price Index and that's up—but this chart has to give you pause to ponder. I know it made me mull over the situation.

Of course, if the trend of rising inflation has ended, then corporate profits are going to be a lot more honest. They are not going to have all those inflation "profits" built into the bottom line. No, if this chart is correct, then the corporate profits that

(cont. on pg. 4)

DEFENSE SECTION

Most or all of the defense information (but not stock information) is based on an exclusive arrangement with **Mr. Melvyn Lippman of US Organization Chart Service**, La Jolla, California.

Question: Mel, with the trouble in Lebanon and Grenada and Central America and the current furor over our military operations, how about telling us just what the military is all about and how it's set up?

Answer: A good question, and I'm now going to give you a number of important facts that very few people are aware of.

FACTS ABOUT THE UNITED STATES DEFENSE ESTABLISHMENT –– PART I

1789 War Department Established.
1798 Navy Department Established.
1942 Joint Chiefs of Staff Established.
1947 National Military Establishment created.
1949 Name changed to Department of Defense (DoD)

The National Security Act of 1947 created, the National Military Establishment, which came into being Sept. 18, 1947. The Army, Navy and Air Force were cabinet-level-Executive Departments, with the Secretary of Defense functioning primarily as a coordinator. In 1949, amendments to the National Security Act established the Secretary of Defense as principal assistant to the President on defense matters and changed the name of the National Military Establishments to the Department of Defense. The amendments also made the military departments subordinate to the Department of Defense and provided for uniform budgetary and fiscal procedures. The Department of Defense Reorganization Act of 1958 took the military departments out of the operational chain of command, which ever since has run from the President to the Secretary of Defense through the Joint Chiefs of Staff to commanders of the unified and specified commands.

DoD at a Glance:

The Pentagon, headquarters of the Department of Defense, is one of the world's largest office buildings. It is virtually a city in itself, housing more than 23,000 people! The building was built in 16 months and was completed on January 15, 1943, at an approximate cost of $83 million. Total land area is 853 acres, the original land cost was $2,245,000. The Pentagon building is 29 acres with 67 acres for parking. The parking capacity is 9,849 vehicles. The gross floor area is 6,546,360 square feet, with net office space at 3,705,793 square feet. Height of building is 71' and total length of corridors is 17½ miles!

People: About 4.7 million in all, including active duty service members, civilian employees and Reserve Forces. More than two million on active duty with the Army, Navy, Marine Corps., and Air Force. About 1.4 million in the Army and Air National Guard and in the Ready Reserves. More than one million civilians.

Places: Almost 1,300 major military installations and properties. About 910 of them in the United States, 334 overseas in 21 countries, and 25 in US territories. In addition there are over 3,000 OTHER US military installations in US possessions and foreign countries. (OTHER installations include - General support annexes - Military National Guard - Ballistic Missile - Electronic Station or Site and Auxiliary airfields and stations). Approximately one-fourth of all active duty personnel are stationed outside of the United States.

Money: Total Obligational Authority for Fiscal Year 1984 proposed at $274.1 billion. This reflects a 10% real growth (adjusted for inflation) over the Fiscal Year 1983 budget. Outlays for Fiscal Year 1984 proposed at $238.6 billion. This represents 6.8% of gross national product, 28.1% of federal outlays, and 19% of net public spending.

THE DEFENSE BUDGET:

Total Obligational Authority (TOA) represents the value of the direct defense program for each fiscal year (this is the TOTAL amount that the defense program is obligated to spend and includes funds assigned to various programs that have not yet been spent including balances available from prior years.

Budget Authority (BA) on the other hand represents the value of the annual NEW authority to spend. Outlays represent actual expenditures.

Breakdown of the Budget:

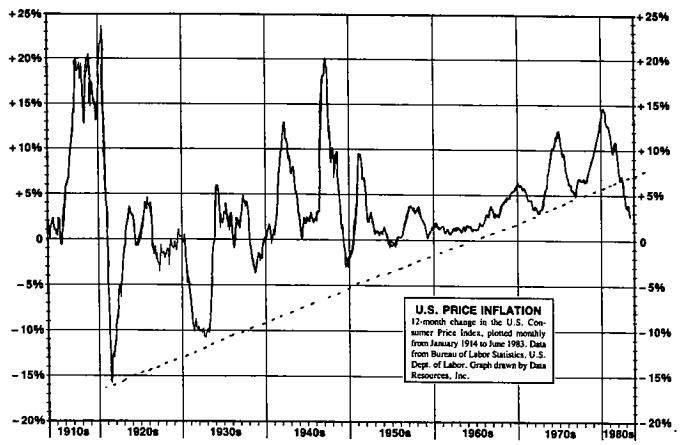
Total Obligational Authority (TOA) – (in billions)

Fiscal Year (FY)	FY 82	FY 83 (E)	FY 84 (E)
Military Personnel	42.8	45.5	47.9
Retired Pay	14.9	16.2	16.8
Operation & Maint.	62.0	80.2	74.0
Family Housing	2.2	2.6	2.8
Military Construction	4.9	4.5	6.0
RDTE (Research)	20.1	22.8	29.6
Other	.3	.9	––
Procurement	64.1	81.9	94.1
	211.3	254.6 (E)	271.2 (E)

(E) = Estimated

Next Letter: PART II: *Facts About the United States Defense Establishment:* Will highlight, Major Weapon Systems and Combat Forces, Organization of the Department of Defense and the Five Armed Services, Defense Treaties, Agreements with whom and several other relevant and timely facts.

(cont. from pg. 3)
you see coming up during 1984 and 1985 are going to be the real McCoy–not a bunch of inflated inventory profits that anybody can show if he's loaded up with a lot of merchandise that is worth more this year than last.



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NOTES & QUOTES: Does the market like communism–any kind of communism? The answer would seem to be a resounding no. Hong Kong, faced with a Chinese takeover in 1997, has seen its markets and the Hong Kong pound collapse. Real estate prices (once high-flying) have caved in, and businessmen are now leaving Hong Kong in droves. Biggest item on the current Hong Kong agenda is the unraveling of giant Carrien Holding Ltd., now in provisional liquidation and owing $1.2 billion. More than 50 international banks have loaned Carrien money, and they will now sweat it out. Biggest creditor is the Hong Kong branch of Malaysia's Bank Bumiperutra, which is owed an incredible $530 million, $230 million of which is unaccounted for!

* *

Do the Russians really mean well? I mean, beneath all that bluster and threat, are the Russians really the good guys, and do they really care about the downtrodden masses (while we rotten capitalists use the masses for our end)? Judge for youself. Here's a little AP clip that I cut out of last week's newspaper (remember Afghanistan?).

Associated Press

ISLAMABAD, Pakistan — Soviet troops have opened a major campaign against Moslem guerrillas in Afghanistan, fighting in seven provinces and bombing a town north of Kabul, Western diplomatic sources said yesterday.

A key target has been the town of Istalef, reportedly 40 percent destroyed after five days of bombing, according to a report from the Afghanistan capital of Kabul made available in Islamabad.

"The smell of death from bodies (buried) in the rubble is apparent even at a distance," was how a traveler described Istalef, 20 miles north of the capital.

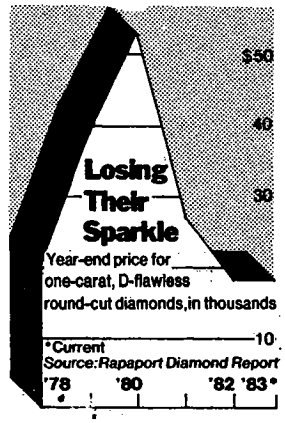
The diplomatic sources said Istalef, a major guerrilla stronghold, is undergoing some of the most savage bombing seen in Afghanistan since Soviet troops entered the country to prop up the pro-Moscow government in late 1979.

* *

Barron's favorite forecaster is S.J. Levy who publishes Industry Forecast (Box 26, Chappaqua, NY 10514). Here are a few excerpts from his most recent report: "Total corporate profits will be little, if any, higher in the first half of 1984 than they are now. The failure of profits to keep pace with sales will result in a squeeze on profits and inhibit business expansion. . . The recent fluctuations in interest rates should not obscure the probability that a major downtrend is now under way. The prospect of considerably lower rates by mid-1984 is excellent."

* *

Whatever happened to "investment-grade" diamonds? Well, they suffered along with the rest of the inflation-oriented "life savers." This chart tells the story. During the wild days of 1980 when gold rose to 850 an ounce, a one-carat D-flawless hit a high of $65,000. Today, you can get a one-carat flawless for about $16,000 or less of 75%. However, it is well to note that this is the case only with the very speculative flawless stones. The commercial grade stones (which are much bigger in sales volume) have held their value.



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I saw this piece in New Woman magazine, and I couldn't resist including it.

A reporter asked George Bernard Shaw to play the "What If" game, shortly before he died. "Mr. Shaw," he said, "you have visited with some of the most famous people in the world. You've known royalty, world-renowned authors, artists, teachers and dignitaries from every part of the world. If you could live your life over and be anybody you've known, or any person from history," the reporter asked, "who would you choose to be?"

"I would choose," replied Shaw, "to be the man George Bernard Shaw could have been, but never was."

* *

I'll be in New Orleans (speaking) at the Tenth Anniversary Conference of the NCMR, and I'll be there November 7 and 8. One new item on the agenda is a big auction of collectibles (put on by Myron Kaller). Myron tells me that they'll be auctioning everything from rare coins, autographs, jewelry, gemstones and diamonds to a vintage Presidential Railroad car. Should be quite a show!

* *

A few months ago I recommended a book entitled "The Road Less Traveled" by Dr. M. Scott Peck. I received a good deal of correspondence from the subscribers regarding this book. People wrote to thank me for the suggestion, and in general it was clear that the book made a big impression on readers.

Peck has just come out with another brilliant and fascinating book entitled "People of the Lie" (Simon and Schuster, $14.95). This book deals with a subject that few people have ever dealt with in an important way–the subject is evil. People who are evil, says Scott, attack others instead of facing their own fears and inadequacies.

Personally, I have always believed that the basis for most of the trouble (evil) in this world is based on the willingness of certain

people to avoid their own pain by transferring that pain on their wives, their children, their friends or to anyone else who is unlucky enough to stand in their path. The Peck book is a very important work, and I recommend it to all subscribers.

* *

Everybody knows that women, on average, live longer than men–right? Right, but a study of 4,394 people who died in Erie County, PA, shows that men who never smoked (or were not killed violently) lived as long as women. In other words, the prevalence of men smokers is the probable reason for women's longer life. Bad news: teenage girls now surpass teen males in smoking–so you can expect the statistics on men and women to change in coming years!

* *

The newspaper, USA Today, has been derided by many critics. But I like it and read it along with six other newspapers each day. USA is addicted to statistics and lists of facts–and I like that too. Recently, USA Today included this "alphabetical list" of tax deductions. I thought it was cute, interesting and useful.

Offbeat deductions from A to Z

The tax code is loaded with special deductions that you easily could overlook. Here are some of the more unusual ones that might apply to you:

Acupuncture sessions
Business publications and magazines
Cosmetic surgery
Dental care costs
Eyeglasses and contact lenses
Fluoride in water when recommended by a dentist
Gambling losses to extent of gambling gains
Hobby losses within limits
Investment club's operating expenses
Job-hunting expenses
Kidney, other organ transplant expenses
Liquor when used for medicinal purposes
Massages when ordered by a doctor
Nurse's uniforms or other work clothes
Organic foods, if prescribed by a doctor
Passport fees if for a business trip
Qualified pension plan donations for business owners
Revolving charge account fees
Sexual therapy
Tax advice books and expenses
Union dues and fines
Vitamins, if prescribed by a doctor
Worthless debts
X-rays and X-ray treatment
Yacht repair and maintenance, if used for business
Zither and or other instrument depreciation and instruction costs for professionals musicians

GOLD: I guess I read most of the "hard money" advisory services that are available. And the thing that I find interesting is that almost to a man–no one has been willing to label gold as in a primary bear market. There is just a stubborn unwillingness to accept the massive decline from the 1980 high of 850 to the 1983 break below 400 as "an ongoing bear market." And I find that *ominous.* It's ominous because the bear (like the bull) likes to be recognized. And when investors stubbornly refuse to give the bear his due–then the bear continues to do his dirty work. So it would not surprise me to see gold go down and down–until finally, the hard money people will throw in the sponge and call it "a bear market."

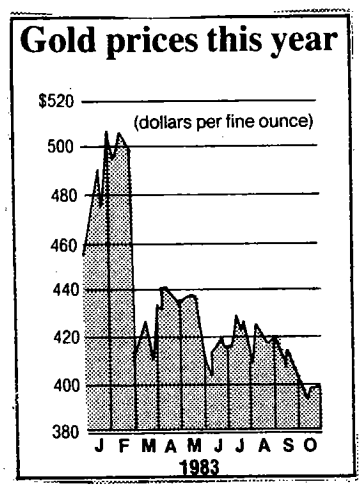
In their latest report the Aden sisters noted that "the 65-week averages (for gold) is now $424 and, although it is rising, the price has now been trading below it for four weeks. This is a significant development and the penetration of the average can no longer be viewed as an aberration. Ever since 1968, when gold began trading in the free market, the price has only crossed the 65-week average at major tops and bottoms. It has never penetrated the average during a correction. On the basis of this indicator alone, the average is giving a sell signal." I agree. (Aden Analysis, 4425 Napoleon Ave., Metairie LA 70001).

So to my mind, the most important thing about gold now is that nobody will give credence to the prevailing primary trend. "Give the bull his due; give the bear his due." To ignore the primary trend is to stir the wrath of the market Gods (which is exactly what is happening now in the precious metals!).

If I've kept any subscribers from losing their shirts in gold and silver and precious metals, I guess my efforts over the last couple of years were worth it. If any further proof was needed, the perfomance of the metals following the Grenada invasion indicated that "news goes with the trend," and the trend is down for the metals. Three years ago, Lebanon and Grenada would have sent gold and silver into orbit. This time–nothing.

What's happened to the metals? Why don't they respond to crises? Answer: because they're in a bear market, and holders of the metals are selling into every event that is calculated to send the metals higher. In the face of high interest rates and a lack of inflation fears, the desire to own gold and silver has evaporated.

Sometimes a certain kind of chart will bring home the facts better than the most detailed report. Along those lines, I thought this little chart showing the gold action through 1983 tells the story. Anyone who examines this chart will have to concede that the primary trend of gold is down. There have been three important rallies in gold during 1983, with each rally peak terminating below the preceding peak. Finally, in October, gold broke below the 400 level–in the midst of what appeared to be a world crisis atmosphere. Gold, in fact, has ceased to respond to crisis. And that's the story–and it's hard to deny it. Gold will rise again some day, but for now it's in a primary bear market and the trend is down until proved otherwise.



LATE NOTES: As of Friday's close (Oct. 28) the D-J Industrial Average had fallen below its October 3 low of 1231.30 (see page 1 chart). The Transports did NOT confirm in that they held above their comparable low (Oct. 3 low) of 560.79. The A-D ratio (see page 2 chart) is just a fraction above its August low. One more decline in the A-D ratio would give us the double non-confirmation I was referring to on page 1. In other words, with a little more weakness in the A-D ratio this market should be ready to etch out an important bottom. The first series of days with advances numbering 1000 or more should signal an important turn to the upside.

NEXT MAILING: Nov. 16